Bialo v. Commissioner, 88 T. C. 1132, 1987 U. S. Tax Ct. LEXIS 63, 88 T. C. No. 63 (1987)

Charitable contribution deductions for section 306 stock are subject to limitations when one of the principal purposes of the stock distribution and redemption is tax avoidance.

Summary

Walter Bialo, the majority shareholder of Universal Luggage Co. , Inc. , received a pro rata dividend of preferred stock, which he donated to a charitable trust. The stock was later redeemed by Universal. The IRS challenged the $100,000 charitable deduction Bialo claimed, arguing it was section 306 stock and thus subject to limitations under section 170(e)(1)(A). The Tax Court held that the transaction was part of a plan to avoid federal income tax, thus the deduction was limited. The decision underscores the scrutiny applied to transactions involving section 306 stock and the burden on taxpayers to prove non-tax avoidance motives.

Facts

Walter Bialo, president of Universal Luggage Co. , Inc. , owned 86% of its common stock. In February 1978, his accountant advised on the tax benefits of contributing appreciated stock to a charity. On August 18, 1978, Universal declared a pro rata dividend of 2,500 shares of preferred stock, which Bialo received proportionately. On August 30, 1978, Bialo contributed 1,000 shares to the New York Community Trust, valued at $89,000. The trust received dividends from Universal before selling the stock back to the corporation for $68,000 on October 26, 1979. Bialo claimed a $100,000 charitable deduction for the donation.

Procedural History

The IRS disallowed Bialo’s charitable deduction, asserting it was section 306 stock and subject to limitations. Bialo petitioned the U. S. Tax Court for a review of the deficiency determination. The Tax Court heard the case and issued its opinion on April 30, 1987, finding in favor of the Commissioner.

Issue(s)

1. Whether the preferred stock distributed to Bialo and subsequently contributed to the New York Community Trust constitutes section 306 stock under section 306(c)(1)(A)?
2. Whether the distribution and redemption of the preferred stock was part of a plan having as one of its principal purposes the avoidance of federal income tax, thus not qualifying for the exception under section 306(b)(4)?
3. Whether Bialo’s charitable contribution deduction for the stock should be limited under section 170(e)(1)(A)?

© 2025 SCOTUSreports.com. All rights reserved.

Holding

1. Yes, because the preferred stock was distributed to Bialo without recognition of gain under section 305(a) and met the definition of section 306 stock.
2. No, because Bialo failed to prove that tax avoidance was not one of the principal purposes of the transaction, thus not qualifying for the section 306(b)(4) exception.
3. Yes, because the transaction involved section 306 stock and was part of a tax avoidance plan, the charitable contribution deduction must be reduced under section 170(e)(1)(A).

Court's Reasoning

The court found that the preferred stock was section 306 stock as defined by section 306(c)(1)(A) since it was distributed without recognition of gain and Bialo did not dispose of the underlying common stock. The court rejected Bialo's argument that the distribution and redemption were not part of a tax avoidance plan, noting that Bialo had the burden of proof to show otherwise. The court cited legislative history and regulations indicating that section 306(b)(4) was intended for isolated dispositions by minority shareholders, not for transactions like Bialo's where control was maintained. The court also referenced case law such as *Roebling v. Commissioner* and *Fireoved v. United States* to support its finding that Bialo's transaction had tax avoidance as a principal purpose. The court emphasized that the tax benefits illustrated in the pre-transaction memorandum outweighed Bialo's post-hoc rationalizations for the use of preferred stock.

Practical Implications

This decision highlights the strict scrutiny applied to transactions involving section 306 stock and the high burden on taxpayers to demonstrate non-tax avoidance motives. Practitioners must advise clients carefully when planning charitable contributions of section 306 stock, ensuring that any non-tax avoidance purpose is well-documented and substantiated. The case also illustrates the limitations on charitable deductions for section 306 stock and the need for clear evidence of non-tax motives to avoid these limitations. Subsequent cases and IRS guidance have continued to reference *Bialo* in analyzing the tax implications of similar transactions. Practitioners should be aware of these implications when structuring charitable contributions to avoid unexpected tax consequences.

© 2025 SCOTUSreports.com. All rights reserved.